

For Publication

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### **Railroad Retirement Maximum**

The total amount of monthly annuities payable under the Railroad Retirement Act to an employee and spouse is limited to a maximum geared to the employee's average monthly earnings prior to retirement. This provision was intended as a "reasonable cap" so that combined employee and spouse benefit payments do not exceed the employee's creditable earnings prior to retirement.

Most retirees and spouses are not affected by this maximum on benefit payments, but the percentage of annuities affected is expected to increase in future years. This maximum provision may also affect long-service retirees with moderate earnings, or retirees with no earnings, in the 10-year period ending with the year the employee's annuity begins.

Tier I railroad retirement benefits, which approximate social security benefits, are used in determining if a reduction for the railroad retirement maximum is required. However, these benefits are not subject to an actual reduction for this maximum. In cases where a maximum reduction is required, it is usually limited to the tier II portion of the spouse annuity payable on the basis of an employee's earnings. Of the 8,300 spouse annuities awarded in fiscal year 1998, some eight percent required reductions, averaging about \$104 per month. Of the 11,400 employee annuities awarded in fiscal year 1998, some two percent initially required reductions, averaging \$182 per month.

The following questions and answers describe the application of this railroad retirement maximum provision.

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**1. On what is the railroad retirement maximum based?**

The maximum limiting the total amount of railroad retirement benefits payable to an employee and spouse is based on the highest two years of the employee's railroad retirement or social security covered earnings in the 10-year period ending with the year the employee's annuity begins.

In most cases, the maximum is, in effect, based on percentages of those earnings in relation to 1/12 of the amount of earnings subject to the social security equivalent tier I tax in the year the annuity begins. Currently, the maximum formula is such that the highest total family benefit initially payable in a given year is about 68 percent of 1/12 of the tier I taxable earnings limit, or just under 92 percent of 1/12 of the tier II taxable earnings limit, for that year.

**2. How is the railroad retirement maximum generally calculated?**

The first step in calculating the railroad retirement maximum is to determine an employee's "final average monthly compensation." An amount is determined by dividing by 24 the employee's total earnings up to the tier II taxable earnings limits for the two highest-earnings years out of the last 10 calendar years, including the year of retirement. Both railroad retirement **and** social security covered earnings are considered in this step of the railroad retirement maximum calculation. To illustrate this first step, assume that an employee retired in September 1998 with earnings in 1997 and 1998 exceeding the tier II taxable earnings limits of \$48,600 in 1997 and \$50,700 in 1998. The employee's final average monthly compensation would be \$4,137.50 (the sum of the 1997 and 1998 tier II taxable earnings limits, which is \$99,300, divided by 24).

The next step in the calculation is to also divide by 24 the **tier I taxable earnings limit** in the year the annuity begins. In this case, 1/24 of the \$68,400 tier I earnings limit in 1998 would be \$2,850.

The monthly benefit maximum for this employee is equal to (a) his final average monthly compensation (\$4,137.50) **but only up to 1/24** of the tier I taxable earnings limit in the year the annuity begins (\$2,850), plus (b) 80% of so much of his final average monthly compensation **as**

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**exceeds 1/24** of the tier I taxable earnings limit. The amount of the final average monthly compensation in excess of \$2,850 is \$1,287.50, 80 percent of which is \$1,030.

The monthly benefits for this employee and spouse at the time of the annuity beginning date in September 1998 would, therefore, be limited to \$3,880 (\$2,850 plus \$1,030) but would be increased for annual cost-of-living adjustments thereafter.

The maximum cannot be more than the final average monthly compensation and cannot be less than \$1,200. However, reductions for early retirement and/or social security or certain other dual benefit entitlements are applied **after** any reductions for the maximum. Consequently, total benefits payable to the employee and spouse may be less than final average monthly compensation, or \$1,200.

**3. Would a long-service employee with high earnings necessarily be affected by the railroad retirement maximum?**

No. Take, for example, an employee, age 63 with 40 years of service and retiring in December 1998, with earnings generally at the tier I maximum, including 1997 and 1998. In this case, monthly benefits for this employee and spouse at the annuity beginning date in December 1998 would be limited to \$3,880.

Assume the employee's tier I benefit to be \$1,360 and his tier II benefit to be \$1,100, and that the employee is also eligible for a supplemental annuity of \$43 a month. In addition, the tier I and tier II benefits of the spouse annuity, for railroad retirement maximum purposes, would be \$680 and \$495, respectively.

The total family benefit payable, before considering the railroad retirement maximum, would be \$3,678. As the maximum based on the employee's earnings in this case is \$3,880, no reduction for the maximum would be required.

As can be seen, the amount of each employee's railroad retirement maximum is dependent entirely upon his or her earnings prior to the annuity beginning date. An employee whose earnings are at least at the level of the tier II taxable earnings limit will gain the benefit of a high railroad retirement

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maximum. (In 1998, the highest possible railroad retirement maximum was \$3,880; in 1999 it is \$4,085.)

However, the calculation of a railroad retirement annuity takes into account lifetime earnings, age at retirement, and years of service, among other factors. These can cause monthly benefits to increase to a point where they exceed the amount of the employee's railroad retirement maximum. If the employee who was not affected by the maximum in the preceding example were to continue working past age 65, and therefore become eligible for delayed retirement credits on top of additional service, family benefits could eventually increase to the point where the maximum would be applicable.

**4. How would this provision be applicable to long-service employees with relatively moderate earnings in the 10-year period?**

Take, for example, an employee, also age 63 with 45 years of service retiring in December 1998, with earnings of \$45,000 in both 1997 and 1998, which were also his highest two years of creditable earnings. In this case, monthly benefits for this employee and spouse at the annuity beginning date in December 1998 would be limited by the maximum computation to \$3,570.

Assume the employee's tier I benefit to be \$1,250 and his tier II benefit to be \$1,150, and that the employee is also eligible for a supplemental annuity of \$43 a month. In addition, spouse benefits would consequently be \$625 and \$517.50 in tier I and tier II amounts, respectively.

The total family benefit payable, before considering the railroad retirement maximum, would be \$3,585.50 per month. As the maximum based on the employee's final average monthly compensation in this case is \$3,570, a reduction of \$15.50 per month would be required. Employees who have earnings less than the taxable earnings limit prior to retirement coupled with very long service should be especially aware of the potential for a maximum reduction in total family benefits.

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**5. What are some examples of the maximum affecting an employee with lesser earnings, or no earnings, under either railroad retirement or social security coverage in the 10-year period up to retirement?**

An example of a person with lesser earnings in the 10 years ending with the year the employee's annuity begins could be an employee who accepted a separation allowance and involuntarily left the rail industry in 1988. Assume that he subsequently worked in a series of part-time social security covered jobs and retires in 1998. His highest two years of creditable earnings in the 10-year period 1989-1998 were 1996 and 1997, during which he earned \$18,000 in each year. Since his final average monthly compensation (\$1,500) is less than 1/24 of the 1998 tier I earnings maximum (\$2,850), the maximum in this case would be the final average monthly compensation of \$1,500.

Assume that the employee in this example had acquired 30 years of railroad service by the time he left the rail industry in 1988. Upon his retirement at age 62 in 1998, his tier I and tier II benefits are calculated as \$1,100 and \$520, respectively, and a supplemental annuity of \$43 is also payable. The tier I and tier II benefits payable to his spouse would be \$550 and \$234, respectively.

The total family benefits in this case, before considering the railroad retirement maximum, would be \$2,447 a month. However, the maximum in this case is the final average monthly compensation of \$1,500. Although a reduction of \$947 is consequently calculated, the actual reduction is limited to \$797, which is the total of those benefits exceeding tier I payments.

In cases of no railroad retirement or social security covered earnings in the 10 years ending with the year the employee's annuity begins, the maximum would be \$1,200. As can be seen, the \$1,200 or other relatively low maximum could substantially reduce the railroad retirement benefits payable. In an extreme case, it could cap benefits at an amount precluding payment of most, or even all, of the tier II benefits and supplemental annuity otherwise due.

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**6. If a reduction for the railroad retirement maximum is required, how is it applied to the railroad retirement annuities payable to the employee and spouse?**

If the total benefits (excluding any vested dual benefits) payable to the employee and spouse **before** reduction for age, social security benefits or other factors exceed the maximum, they must be brought down to the maximum amount. This is done by first reducing the spouse's tier II benefit. If the total family benefits still exceed the maximum, the railroad employee's supplemental annuity is reduced. Finally, if total benefits still exceed the maximum, the employee's tier II benefit would be reduced.

If a spouse is not yet eligible for an annuity at the time of the employee's retirement, any required reduction would be applied when the spouse is actually awarded the annuity. If any further reductions for the maximum were also required, they would be applied to the employee's supplemental annuity and/or tier II benefits at that time. The only instance in which an employee's annuity would be reduced for the maximum prior to the actual award of a spouse annuity is when the employee's tier I benefit, tier II benefit and supplemental annuity alone exceed the individual maximum for that case.

Tier I employee and spouse benefits and any vested dual benefits payable are not subject to reduction for the railroad retirement maximum.

**7. How can an employee get more information about this maximum provision?**

Board field office personnel can provide rail employees with annuity estimates which would reflect any maximum provisions applicable, as well as information on other railroad retirement-related matters.

Most Board field offices are open to the public from 9:00 a.m. to 3:30 p.m., Monday through Friday.